INITIAL STATEMENT OF REASONS/PLAIN ENGLISH
OVERVIEW/NON-CONTROLLING SUMMARY

REGULATION 1502, COMPUTERS, PROGRAMS, AND DATA PROCESSING

Regulation 1502 interprets and explains the application of sales and use tax to sales of computers and computer programs, as defined. It explains when such sales are subject to sales and use tax and when they are not.

Specific Purpose

The purpose of the proposed amendments is to interpret, implement, and make specific Revenue and Taxation Code section 6010.9. These amendments are necessary to provide guidance to that portion of the public which is affected by this statute.

Factual Basis

Regulation 1502 discusses the application of tax to sales of computers and data processing programs. In part, it provides definitions of various terms used in the statute.

Amendments are proposed to clarify the statutory definition of "computer program." Specifically, the amendments are necessary to: (1) clarify that the definition of a computer program includes "both systems and application programs and subdivisions, such as assemblers, compilers, routines, generators, and utility programs," as described in Revenue and Taxation Code section 6010.9, subdivision (c); and (2) harmonize the definition of "computer program" contained in subdivision (c) with the definitional and related explanatory provisions pertaining to "customer computer programs" and "existing prewritten programs" set forth in subdivision (d).

Revenue and Taxation Code section 6010.9, subdivision (c) and existing Board Sales and Use Tax Regulation 1502 (b) (10) both define "computer program" to mean the "complete plan for the solution of a problem, such as the complete sequence of automatic data-processing equipment instructions necessary to solve a problem and includes both systems and application programs and subdivisions, such as assemblers, compilers, routines, generators, and utility programs."

Statutes and regulations should be interpreted logically and consistently. In particular, statutes and regulations should be interpreted so as to be internally consistent. The phrase "complete plan for the solution of a problem" should be defined broadly enough to encompass all of the different types of "problems" that a program or subdivision of a program, such as an assembler, compiler, routine, generator, or utility program, may be created or used to address or solve. Such software building blocks obviously are created and used to solve numerous and diverse programming problems, even if taken discretely, in and of themselves, they may not be capable of fulfilling a specific purchaser's or user's complete and ultimate software needs. Therefore, the Board has concluded that to narrowly define a computer problem as only one that satisfies the full array of a purchaser's software needs in each and every instance would improperly create an internal conflict within the definitional provisions of the statute and regulation because these provisions expressly include such software building blocks as subdivisions and routines within their definition of "program." The proposed regulatory amendment is intended to clarify the statute and regulation to preclude such an impermissibly narrow interpretation, and prevent an internally self-contradictory construction of the definitional provisions set forth in Revenue and Taxation

Taxation Code section 6010.9.

Revenue and Taxation Code section 6010.9, subdivision (d), provides that "custom computer program" means "a computer program prepared to the special order of the customer and includes those services represented by separately stated charges for modifications to an existing prewritten program which are prepared to the special order of the customer. The term does not include a 'canned' or prewritten computer program which is held or existing for general or repeated sale or lease, even if the prewritten or 'canned' program was initially developed on a custom basis or for in-house use. Modification to an existing prewritten program to meet the customer's needs is custom computer programming only to the extent of the modification."

Statutory provisions should be interpreted to be consistent and in harmony with related provisions. With respect to the above statutory language, if an existing prewritten program does not "meet the customer's needs" and, thus, needs custom "modification," then it cannot be said to be capable of fulfilling that customer's complete and ultimate software needs. Nevertheless, the statute expressly and explicitly deems such prewritten software requiring modification and customization to be a "program." Thus, it is obvious that the Legislature did not mean to exclude prewritten software that did not fully satisfy each and every need of a customer from the definition of computer program.

Therefore, to define a computer program as only one that satisfies the full array of the customer's software needs in each and every instance, without the need for the slightest amount of customization or data input, would improperly create a conflict with the express provisions of section 6010.9, subdivisions (c) and (d), which address the sales and use tax consequences of defining a program as either custom or prewritten (or "canned"). Nevertheless, a number of taxpayers have contended that a prewritten computer program, even one that contains millions of lines of compiled software code, does not qualify as a "computer program" under Revenue and Taxation Code section 6010.9, if it needs the slightest quantum of customization, or data or parameter input, before installation and operation. The Board has concluded that the instant amendment is necessary to clarify that such contention is both erroneous and incompatible with California law.

Pursuant to Government Code section 11346.5(a)(8), the Board of Equalization finds that the adoption of the proposed amendments will not have a significant adverse economic impact on private businesses or persons. The amendments are proposed to interpret, implement, and make specific the authorizing statutes in the context covered by the regulation for greater ease of understanding. These changes will clarify the interpretation or administration of the sales and use tax laws. Therefore, the Board has determined that these changes will not have a significant adverse economic impact on private businesses or persons.